RHB Islamic Bank Bhd v AmGeneral Insurance Bhd (formerly known as Kurnia Insurans (M) Bhd) & Ors and other appeals

FEDERAL COURT (PUTRAJAYA) — CIVIL APPEAL NOS 02(f)-35–05 OF 2018(B), 02(f)-36–05 OF 2018(B) AND 02(f)-37–05 OF 2018(B)
ZAHARAH IBRAHIM CJ (MALAYA), DAVID WONG CJ (SABAH AND SARAWAK), RAMLY ALI, BALIA YUSOF AND ALIZATUL KHAIR FCJJ
13 MAY 2019

Insurance — Fire insurance — Standard mortgagee clause in policy — Whether standard mortgagee clause in contract of insurance between insurer and insured separate and independent contract between insurer and mortgagee of insured's property — Whether such clause entitled mortgagee to sue insurer for payment under the policy if insured risk occurred regardless of whether insured itself breached the policy in any way thus entitling insurer to repudiate its claim — Whether mortgagee's conduct alone determined the validity of its claim under the mortgagee clause — Whether mortgagee's entitlement to be paid under the policy upon occurrence of loss was in addition to, and unaffected by, its right to sue and recover monies owing to it by the insured under any other contract in respect of which the mortgage was created

Veheng Global Traders Sdn Bhd ('Veheng') purchased four fire insurance policies from AmGeneral Insurance Bhd and Sun Life Malaysia Takaful Bhd ('the respondents') in respect of its assets for a one-year period. The policy with which the instant appeal was concerned was a RM45m fire material damage policy ('the FMD policy') which was insured by both the respondents. RHB Islamic Bank Bhd ('RHB'), which had granted credit facilities to Veheng, was referred to in the FMD policy as being the mortgagee over Veheng's assets and there was a mortgagee clause in the policy setting out the terms and conditions applicable to RHB. A fire at Veheng's premises destroyed its assets. Veheng claimed against the respondents for payment under the four policies but they repudiated liability on the ground the fire was deliberately caused by Veheng. Veheng had executed a deed of assignment assigning all its rights and interests over the proceeds under the FMD policy to RHB as an additional security for the credit facilities. RHB sued the respondents in the High Court for payment under the FMD policy based on the mortgagee clause as well as the deed of assignment contending that its claim was not affected or invalidated by Veheng's conduct, neglect or breach under the policy. The High Court decided in RHB's favour and after assessing Veheng's loss of stock at RM38,799,784, ordered the respondents to pay that sum to RHB with interest. On the respondents' appeal, the Court of Appeal ('COA') reversed the High Court's decision holding that: (a) although RHB was referred to as Veheng's mortgagee

in the FMD policy, it was a stranger to the insurance contract between Veheng and the respondents and therefore had no locus standi to sue for payment under the policy; (b) the mortgagee clause was simply a 'loss payable clause' and since no loss arose, on account of the respondents' repudiation of Veheng's claim, no payment to RHB under the mortgagee clause was due; (c) the mortgagee clause did not create a separate contract between RHB and the respondents; (d) RHB was not entitled to payment under the deed of assignment because the assignor's claim had been repudiated for breach of the policy; and (e) the quantum awarded by the High Court to RHB was unjustified as Veheng had not proven its loss; furthermore, the respondents' own adjuster had assessed Veheng's stock loss as not more than RM23.36m. The instant appeal was against the COA's decision.

Held, unanimously allowing the appeal, setting aside the COA's decision, restoring the order of the High Court but varying the amount awarded to RM23.36m:

(1) The mortgagee clause in the instant case, read as a whole, was, word for word, a standard New York mortgagee clause (also known simply as a 'standard mortgagee clause') which created privity between RHB and the respondents. The COA therefore erred in holding that RHB lacked locus standi to sue the respondents for the insurance proceeds. Since the mortgagee clause clothed RHB with the necessary locus standi, issues surrounding the deed of assignment in the instant case became academic. In any event, standard New York mortgagee clauses did not amount to assignments as they were separate and independent contracts; hence the question that the assignee (RHB) could not be in a better position than the assignor (Veheng) did not arise (see paras 35–36, 55, 65 & 79).

(2) Mortgagee clauses were recognised by American and Canadian courts as creating a separate and independent contract between the insurer and the mortgagee. The consideration for the contract was the right of subrogation. The insurer was required to reimburse the mortgagee the money owed and upon doing so, it acquired the right to take the place of the mortgagee to sue the party at fault to recover the sum it had paid to the mortgagee. Even under English common law, the legal position in most cases was the same. The English courts approached the matter by drawing a distinction between 'composite' and 'joint' policies. It appeared that the English, American and Canadian courts had a unified reasoning on mortgagee clauses. Whether one called it a 'composite policy' or otherwise, the intention behind the drafting of mortgagee clauses was clearly to create a separate and independent contract with distinct terms and conditions between the mortgagee and the insurers. In view of the unified approach taken by the courts in those countries there was no reason to arrive at a different conclusion especially as the

mortgagee clause in the instant case was word for word almost identical with the standard New York mortgagee clause (see paras 44, 55–57 & 63).

(3) Since the contract of indemnity between the insurers and the mortgagee existed independently of the contract between the insurer and the insured, the finding of fraud (or any other vitiating factor) as between the insured and the insurer had no bearing to the mortgagee's claim. The validity and entitlement of the mortgagee to the insurance proceeds had to be assessed on the conduct of the mortgagee alone (see para 68).

(4) It did not offend public policy if an innocent mortgagee was paid under the mortgagee clause even when the insured was in breach of the policy of insurance. As there was a right of subrogation and the insurer had the absolute right to sue the insured to the extent of the monies it had paid to the mortgagee, the issue of public policy and the insured benefitting by reason of payment to the mortgagee did not apply at all. The court had to give effect to the intention of the contracting parties. A plain reading of the mortgagee clause showed that the respondents intended to indemnify RHB notwithstanding any disentitlement of Veheng to the same (see paras 27(ii), 66, 72 & 78).

(5) RHB's obtaining of summary judgment against Veheng for the amount owing under the credit facilities was not inconsistent with its right to claim indemnity from the respondents under the insurance policy. The intention of the parties under the mortgagee clause was that should Veheng or any other third party occasion loss, it was open to RHB to enforce its contractual rights against Veheng for any outstanding amount under the loan and at the same time enforce its contractual right of indemnity under the insurance policy against the respondents. The former was RHB's enforcement of suretyship; the latter was its right to claim indemnity upon the materialisation of the risk under the policy (see paras 82 & 89–90).

(6) RHB was entitled to be paid the sum of RM23.36m by the respondents as this was the loss amount assessed by the respondents' own adjuster (see para 92).

[Bahasa Malaysia summary

Veheng Global Traders Sdn Bhd ('Veheng') membeli empat polisi insurans kebakaran dari AmGeneral Insurance Bhd dan Sun Life Malaysia Takaful Bhd ('responden') berkenaan asetnya selama tempoh satu tahun. Polisi yang mana rayuan ini berkenaan adalah polisi kerosakan kebakaran RM45 juta ('polisi FMD') yang diinsuranskan oleh kedua-dua responden. RHB Islamic Bank Bhd ('RHB'), yang telah memberikan kemudahan kredit kepada Veheng, dirujuk dalam polisi FMD sebagai pemegang gadai janji atas aset Veheng dan terdapat klausa pemegang gadai janji dalam polisi yang menetapkan terma dan

syarat yang terpakai kepada RHB. Kebakaran di premis Veheng memusnahkan asetnya. Veheng menuntut terhadap responden untuk pembayaran di bawah empat polisi tetapi mereka menolak liabiliti atas alasan kebakaran itu sengaja disebabkan oleh Veheng. Veheng telah melaksanakan surat ikatan penyerahakkan yang menyerahkan semua hak dan kepentingannya ke atas hasil di bawah polisi FMD kepada RHB sebagai jaminan tambahan untuk kemudahan kredit. RHB menyaman responden di Mahkamah Tinggi untuk pembayaran di bawah polisi FMD berdasarkan klausa pemegang gadai janji dan surat ikatan penyerahakkan menyatakan bahawa tuntutannya tidak terjejas atau tidak sah oleh kelakuan, pengabaian atau pelanggaran Veheng di bawah polisi tersebut. Mahkamah Tinggi memutuskan untuk memihak kepada RHB dan selepas menilai kehilangan saham Veheng pada RM38,799,784, memerintahkan responden untuk membayar jumlah tersebut kepada RHB dengan faedah. Mengenai rayuan responden, Mahkamah Rayuan ('MR') mengakas keputusan Mahkamah Tinggi memutuskan bahawa: (a) walaupun RHB dirujuk sebagai pemegang gadai janji Veheng dalam polisi FMD, ia adalah orang asing kepada kontrak insurans antara Veheng dan responden dan oleh itu tidak mempunyai locus standi untuk menuntut pembayaran di bawah polisi; (b) klausa pemegang gadai janji adalah sekadar 'klausa kerugian yang perlu dibayar' dan oleh kerana tiada kerugian yang timbul, oleh sebab penolakan responden terhadap tuntutan Veheng, tiada pembayaran kepada RHB di bawah klausa pemegang gadai janji adalah dihutang; (c) klausa pemegang gadai janji tidak mencipta kontrak berasingan antara RHB dan responden; (d) RHB tidak berhak untuk pembayaran di bawah surat ikatan penyerahakkan kerana tuntutan penyerah telah ditolak kerana melanggar polisi; dan (e) kuantum yang diberikan oleh Mahkamah Tinggi kepada RHB adalah tidak wajar kerana Veheng tidak membuktikan kerugiannya; selain itu, penilai responden sendiri telah menilai kehilangan saham Veheng sebagai tidak lebih daripada RM23.36 juta. Rayuan ini adalah terhadap keputusan MR.

Diputuskan, sebulat suara membenarkan rayuan, mengetepikan keputusan MR, mengekalkan perintah Mahkamah Tinggi tetapi mengubah jumlah yang diaward kepada RM23.36 juta:

(1) Klausa pemegang gadai janji dalam kes ini, dibaca secara keseluruhannya, adalah, perkataan demi perkataan, klausa pemegang gadai janji *standard* New York (juga dikenali sebagai 'klausa pemegang gadai janji standard') yang mewujudkan priviti antara RHB dan responden. Oleh itu, MR terkhilaf dalam memutuskan RHB tidak mempunyai locus standi untuk menyaman responden untuk hasil insurans. Memandangkan klausa pemegang gadai janji memberikan RHB dengan lokus standi yang diperlukan, isu-isu yang berkaitan dengan surat ikatan penyerahakkan dalam kes ini menjadi akademik. Walau apapun, klausa pemegang gadai janji *standard* New York tidak berjumlah lantikan kerana mereka adalah

kontrak yang berasingan dan bebas; oleh itu persoalan bahawa pemegang serah hak (RHB) tidak boleh berada dalam kedudukan yang lebih baik daripada penyerah (Veheng) tidak timbul (lihat perenggan 35–36, 55, 65 & 79).

(2) Klausa pemegang gadai janji telah diiktiraf oleh mahkamah Amerika dan Kanada sebagai mewujudkan kontrak berasingan dan bebas antara penanggung insurans dan pemegang gadai janji. Pertimbangan untuk kontrak adalah hak subrogasi. Penanggung insurans dikehendaki untuk membayar balik pemegang gadai janji yang terhutang dan setelah itu, ia memperoleh hak untuk mengambil tempat pemegang gadai janji untuk menuntut pihak yang bersalah untuk mendapatkan jumlah wang yang telah dibayar kepada pemegang gadai janji tersebut. Malah di bawah undang-undang umum Inggeris, kedudukan undang-undang dalam kebanyakan kes adalah sama. Mahkamah Inggeris mendekati perkara itu dengan menarik perbezaan antara polisi 'komposit' dan 'bersama'. Ia kelihatan bahawa mahkamah Inggeris, Amerika dan Kanada mempunyai alasan yang sama pada klausa pemegang gadai janji. Sama ada yang memanggilnya sebagai 'polisi komposit' atau sebaliknya, niat di sebalik perangkaan klausa pemegang gadai janji adalah jelas untuk mewujudkan kontrak berasingan dan bebas dengan terma dan syarat yang jelas antara pemegang gadai janji dan penanggung insurans. Memandangkan pendekatan sama yang diambil oleh mahkamah di negara-negara tersebut tidak ada alasan untuk tiba di kesimpulan yang berbeza terutama kerana klausa pemegang gadai janji dalam kes ini adalah perkataan demi perkataan yang hampir sama dengan klausa pemegang gadai janji *standard* New York (lihat perenggan 44, 55–57 & 63).

(3) Oleh kerana kontrak indemniti antara penanggung insurans dan pemegang gadai janji wujud secara bebas daripada kontrak antara penanggung insurans dan pihak yang diinsuranskan, penemuan penipuan (atau faktor penolakan yang lain) di antara pihak yang diinsuranskan dan penanggung insurans tidak mempunyai kesan kepada pemegang gadai janji tuntutan. Kesahan dan kelayakan pemegang gadai janji kepada hasil insurans perlu dinilai atas kelakuan pemegang gadai sahaja (lihat perenggan 68).

(4) Ia tidak menyinggung dasar awam sekiranya pemegang gadai janji yang tidak bersalah telah dibayar di bawah klausa pemegang gadai janji walaupun pihak yang diinsuranskan itu melanggar dasar insurans. Memandangkan terdapat hak subrogasi dan penanggung insurans mempunyai hak mutlak untuk menuntut pihak yang diinsuranskan setakat mana wang yang telah dibayar kepada pemegang gadai janji, isu dasar awam dan pihak yang diinsuranskan yang mendapat faedah dengan alasan pembayaran kepada gadai janji itu tidak terpakai sama sekali. Mahkamah perlu memberi kesan kepada niat pihak-pihak yang

berkontrak. Pembacaan biasa klausa pemegang gadai janji menunjukkan bahawa responden berhasrat untuk menanggung rugi RHB walau apa pun penolakan Veheng terhadap sama (lihat perenggan 27(ii), 66, 72 & 78).

(5) RHB memperoleh penghakiman terus terhadap Veheng untuk jumlah yang terhutang di bawah kemudahan kredit tidak konsisten dengan hak untuk menuntut ganti rugi daripada responden di bawah polisi insurans. Hasrat pihak-pihak di bawah klausa pemegang gadai janji adalah bahawa jika Veheng atau mana-mana kerugian pihak ketiga yang lain, ia terbuka kepada RHB untuk menguatkuasakan hak kontraknya terhadap Veheng bagi apa-apa jumlah tertunggak di bawah pinjaman dan pada masa yang sama menguatkuasakan hak kontraknya untuk menanggung rugi di bawah polisi insurans terhadap responden. Yang sebelumnya adalah penguatkuasaan jaminan RHB; yang selepasnya adalah hak untuk menuntut ganti rugi apabila penzahiran risiko di bawah polisi (lihat perenggan 82 & 89–90).

(6) RHB berhak dibayar sejumlah RM23.36 juta oleh responden kerana ini adalah jumlah kerugian yang dinilai oleh penilai responden sendiri (lihat perenggan 92).]

Notes

For cases on fire insurance in general, see 8(1) *Mallal's Digest* (5th Ed, 2017 Reissue) paras 142–198.

Cases referred to

Arab Bank plc v Zurich Insurance Co Banque Bruxelles Lambert SA v Zurich Insurance Co and another [1998] All ER (D) 273, QBD (refd)

Caisse Populaire des deux Rives v Société Mutuelle d'Assurance Contre l'Incendie de la Vallée du Richelieu (1984) 19 DLR (4th) 411, SC (refd)

Corbin v Aetna Life & Casualty Co (1978) US Dist LEXIS 19436; (1978) 447 F Supp 646 (folld)

Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd [1915] AC 847, HL (refd)

Hastings v Westchester Fire Ins Co (1878) NY LEXIS 591; (1878) 73 NY 141, CA (refd)

Kepong Prospecting Ltd & Ors v Schmidt [1968] 1 MLJ 170, PC (refd)

Pinder v Farmers' Mutual Insurance Co (Lindsay) [2009] OJ No 4964; 313 DLR (4th) 482, CA (refd)

RHB Islamic Bank Berhad v Veheng Global Trader Sdn Bhd & Ors [2011] 1 LNS 684, HC (refd)

Standard Chartered Bank v KTS Sdn Bhd [2006] 4 MLJ 617; [2006] 4 CLJ 79, FC (refd)

Takako Sakao (f) v Ng Pek Yuen (f) & Anor [2009] 6 MLJ 751, FC (refd)

Tattersall v Drysdale [1935] 2 KB 174, KBD (refd)

Trans Canada Credit Corporation v Royal Insurance Company of Canada [1983]

NSJ No 440; 149 DLR (3d) 280, SC (refd)
Vandepitte v Preferred Accident Insurance Corpn of New York [1933] AC 70, PC (refd)

Legislation referred to

Civil Law Act 1956 s 4(3)
Contracts (Rights of Third Parties) Act 1999 [UK]
Contracts Act 1950
Road Traffic Act 1930 [UK] s 36(4)
Road Transport Act 1987 s 91(3)

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Alizatul Khair FCJ (delivering judgment of the court):

INTRODUCTION

[1] This appeal, Civil Appeal No 02(f)-35–05 of 2018, was heard together with Civil Appeal No 02(f)-36–05 of 2018(B) ('Appeal No 36') and Civil Appeal No 02(f)-37–05 of 2018(B) ('Appeal No 37'). The appellant in both Appeal Nos 36 and 37 is Veheng Global Traders Sdn Bhd, the third respondent in this appeal.

[2] The background facts pertaining to these two appeals (Appeal Nos 36 and 37) have been set out in my brother Justice Ramly Ali's judgment. As with the other two appeals, this appeal arose out of the decision of the Court of Appeal which had allowed the appeals brought by the first and second respondents against the decision of the High Court. The High Court had granted the claims of both the third respondent and the appellant.

SALIENT FACTS

[3] For the purpose of this judgment, the salient facts pertaining to this appeal which we adopt from the appellant's written submission (with some modification) are as follows.

[4] The third respondent had purchased four insurance policies from the first and second respondents to protect all its assets located at Lot 711 A, Jalan

Batu Tiga, Sungai Rasau, Seksyen 16, 40200, Shah Alam for a period from 1 July 2008–30 June 2009 against fire. One of the insurance policies and the one which we are concerned with here, was Fire Insurance Policy No HB-0-08-H000005 (Fire Material Damage Policy No HB-0-08-H000005) issued to the insured in the sum of RM45m ('FMD Policy 005').

[5] In respect of the FMD Policy 005, the second respondent is the co-insurer via CIMB Aviva Takaful Policy No THOOFR01080000004. From the total insured sum of RM45m the first respondent and second respondent insured the sum of 87.5% and 12.5% respectively.

[6] The appellant (RHB Islamic Bank Bhd) had granted a *murabahah* revolving credit facility to the third respondent that was subsequently restructured to a commodity *murabahah* overdraft-i' facility totalling a sum of RM30m vide letter of offers dated 29 June 2006 and 6 April 2009 and a facility agreement dated 23 June 2009.

[7] It is not disputed that in the FMD Policy 005, the appellant is cited as the MORTGAGEE over the third respondent's assets (see the Schedule to the FMD Policy 005). There is also a mortgagee clause in the said FMD Policy 005 namely cl 006(A) that sets out the terms and conditions applicable to the appellant.

[8] Fire broke out at the third respondent's premises on 5 January 2009 and damaged the third respondent's assets and properties extensively. The third respondent proceeded to make a claim against the first and second respondents under the four policies of insurance mentioned earlier.

[9] Pursuant to the restructuring of the *murabahah* revolving credit facilities, the third respondent was required to assign the insurance proceeds under this FMD Policy 005 to the appellant as an additional security for the restructured 'Commodity Murabahah Overdraft-i' facilities'. Thus, a deed of assignment of insurance proceeds dated 14 May 2009 was subsequently executed between the third respondent and the appellant whereby all of the third respondent's rights and interest over the insurance proceeds in the FMD Policy 005 were assigned to the appellant. This was done more than four and a half months after the fire occurred.

[10] The first respondent through their solicitors letter dated 16 July 2009 repudiated all its liabilities under the four policies and refused to pay the third respondent.

[11] The appellant's claim in the High Court suit was only in respect of FMD Policy 005 wherein the appellant's claim is based upon the:

(a) the mortgagee clause that is cl 006(A) of the FMD Policy 005; and

(b) the deed of assignment executed between the appellant and the third respondent of only the proceeds of the fire insurance in respect of FMD Policy 005, notice of which according to the appellant was provided to the respondents.

[12] It was the appellant's contention that the first and second respondents are liable to pay under the FMD Policy 005 based on the mortgagee clause regardless of whether the fire was deliberately caused by the third respondent's conduct, neglect or breaches under the said policy as the same will not affect or invalidate the appellant's claim.

[13] Thus the central issue in this judgment is whether the appellant is entitled, pursuant to the mortgagee clause, to the insurance proceeds from the first and second respondents.

THE DECISION OF THE HIGH COURT

[14] A stated earlier, the High Court after a full trial held that the appellant was entitled to the said insurance proceeds.

[15] The learned High Court judge disagreed with the first and second respondents' defence, inter alia, that they were not liable to pay the appellant since there was no privity of contract between them and the appellant and as such the appellant did not have the locus standi to bring this suit. The learned judge however found that the appellant had the necessary locus standi to sue the first and second respondents by virtue of the mortgagee clause.

[16] On the appellant's entitlement to coverage, the learned High Court judge appeared to agree with the appellant's submission as follows:

> It was the stance of the second plaintiff (the appellant) that based on the mortgagee clause which makes it clear that any loss or damage shall be payable to the second plaintiff irrespective of whether there is any act or neglect on the part of the insured (first plaintiff) (third respondent) or whether the insurer had breached the terms and conditions of the policy. Thus even if the first plaintiff's claim is repudiated and there is no liability to pay the first plaintiff, the defendants (first and second respondents) must pay the second plaintiff based on the mortgagee clause and the defendants may be subrogated to the rights of the mortgagee and be put in the position of the mortgagee and claim the sums paid from the defendants.

[17] On the assignment issue, the learned judge found as follows:

(a) condition 9(d) of the FMD Policies and FCL policies applies only where the consent of the first and second respondents must be obtained in order to assign the fire policy before the occurrence of the fire loss; and

(b) that condition 12 which requires notification of claim to be made within 15 days after loss or damage does not extend to the appellant as the appellant had only come into the picture upon the assignment being created by the third respondent.

[18] On quantum, the learned judge ordered that the first and second respondents pay to the appellant the sum of RM38,799,784 with 5% interest per annum from the date of filing of the writ until full payment. The learned judge had evaluated the third respondent's stock loss at RM38,799,784.

THE DECISION OF THE COURT OF APPEAL

[19] At the Court of Appeal, the appellant justified its claim to the insurance proceeds on two fronts. First, on the mortgagee clause and second, on the deed of assignment dated 14 May 2009 ('deed of assignment'). The High Court had allowed the claim on both grounds. The Court of Appeal reversed the High Court's decision. In reversing the High Court's decision, the Court of Appeal found as follows.

The mortgagee clause

[20] In respect of the mortgagee clause, the Court of Appeal was of the view that the appellant had no locus standi to sue for the proceeds because the policy was only between the first, second, and third respondents. While the appellant may have been named in the policy, it is not a party to it. Applying the doctrine of privity of contract, the appellant was a stranger to the contract and accordingly it has no right to claim for the insurance proceeds.

[21] In essence the Court of Appeal's reasoning on this issue may be summarised in the following manner:

(a) the mere mention of the appellant as a mortgagee in the FMD policy is not sufficient confer a right in the appellant (a third party) to sue the insurer. In other words as the appellant is not a contracting party to the FMD policy it has no locus to sue the insurer for the insurance proceed;

(b) the mortgagee clause is simply a 'loss payable clause'. Absent loss, the appellant could have no claim. In this case, there was evidence of breaches by the third respondent which exonerated first and second respondents from any liabilities. There was no loss payable and therefore the mortgagee clause was not triggered;

(c) in any event, a mortgagee could be entitled to the proceeds if the mortgagee clause evidenced an assignment. A reading of the said clause which required the consent of the insurers before the policy can be assigned (condition 9(d) of the FMD policy) suggested that there was no assignment. The learned High Court judge had held that condition 9(d) only applies if the policy is to be assigned before the occurrence of the fire. That the appellant and the third respondent had drawn up the deed of assignment post the fire further evidenced the lack of intention to render the mortgagee clause an assignment; and

(d) after examining several authorities from various jurisdictions, the Court of Appeal came to the conclusion that a mortgagee may avail himself of a mortgagee clause if the policy was itself a composite insurance policy. The Court of Appeal referred to the Canadian case in support of this point namely the case of *Caisse Populaire des deux Rives v Société Mutuelle d'Assurance Contre l'Incendie de la Vallée du Richelieu* (1984) 19 DLR (4th) 411. The Supreme Court of Canada did deliberate on the issue of public policy, that a person cannot benefit from his own wrong doings. The Canadian court took the view that while the insured in that case had breached a term of the policy by burning the insured property, and therefore could not benefit from his own wrong, the creditor is not under the same contract because the Supreme Court found the hypothecary clause created two distinct contracts between the insured and the mortgagee with the insurer. However, the Court of Appeal found that on the facts of the present case, the appellant cannot be allowed to succeed on the composite policy point as doing so would offend public policy. If the appellant's claim is allowed it 'tantamounts to the first respondent benefiting from its own wrong. By its wrongdoing the first respondent's liability to the second respondent under the loan agreement would appear to be discharged by that wrongdoing' (see para 229 of the Court of Appeal judgment).

The Court of Appeal came to that conclusion because it was of the view that the mortgagee clause did not create a separate contract between the appellant and the insurer.

The deed of assignment

[22] The Court of Appeal agreed that the assignment was validly created under s 4(3) of the Civil Law Act 1956. However, the Court opined that an assignee cannot be in a better position than that of the assignor. Considering that the assignor was found to have no right to the proceeds, the assignee too is equally disentitled.

[23] The Court of Appeal further opined that the two claims respectively under the mortgagee clause and the deed of assignment were in conflict. On the

one hand, the appellant laid its claim as though it was a contracting party vide the mortgagee clause, while on the other hand, it claimed as an assignee under the deed of assignment.

[24] Lastly, the court below reiterated that the third respondent had breached the policy and had no right to indemnity. In this sense, the appellant's claim had no footing because the third respondent was not entitled to the proceeds having breached the contract. In short, the third respondent was not entitled to the insurance proceeds and hence, he could not have had anything to assign to the appellant.

Quantum

[25] Besides liability, the Court of Appeal also disagreed with the findings of the High Court judge in respect of the RM38,799,784 awarded to the appellant. The Court of Appeal noted that the policy being an 'unvalued policy' and 'indemnity in nature' required the insured to prove actual loss arising from the fire incident. This the third respondent failed to do. The Court of Appeal concluded that theirs was an exaggerated claim and that it was not proved in accordance with basic principles of evidence.

[26] The Court of Appeal seemed to agree that taking into account the Mestari Adjuster's report (the first and second respondent's own adjusters) the stock loss would not have exceeded RM23.36m.

THE LEAVE QUESTIONS

[27] Aggrieved with the Court of Appeal's decision, the appellant appealed against the whole of the decision of the Court of Appeal. On 3 May 2018, this court allowed the following leave questions:

(i) whether the mortgagee clause which is a standard clause in all fire policies, where a mortgagee's interest is noted, confer the mortgagee with the right/locus to sue the insurer to recover any loss caused by the fire?

(ii) does it offend public policy for an innocent mortgagee to be paid on the mortgagee clause when the insured is in breach of the policy of insurance and the mortgagee clause explicitly provides that the insurer be subrogated to the rights of the mortgagee and can recover that loss from the insured?

(iii) other than the terms set out in the mortgagee clause, is there any obligation on the mortgagee to comply with other terms and conditions of the policy of insurance?

A (iv) when the proceeds of a policy of insurance have been assigned to the applicant and which assignment complies with s 4(3) of the Civil Law Act 1956, does that assignment confer on the applicant/assignee the right to sue and recover the assigned proceeds? and

B (v) is it inconsistent for a mortgagee to sue under the terms of the mortgagee clause and also to claim for the insurance proceeds where the deed of assignment of the insurance proceeds is executed in favour of the mortgagee four and a half months after the occurrence of the fire?

C OUR DECISION

Mortgagee clauses

[28] Before proceeding to discuss this subject, we need to state some general D principles with regard to the doctrine of privity of contract. The doctrine of privity of contract is the general rule whereby a stranger to a contract has no rights to sue on the same. This is the case even if the said non-party receives benefits under that contract. See generally: *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd* [1915] AC 847; and *Kepong Prospecting Ltd & Ors v* E *Schmidt* [1968] 1 MLJ 170.

[29] That being said, the doctrine has its exceptions. Trusts being creatures of equity, are one such exception. In a typical case, a settlor bequeaths his property to another, called the trustee, for the benefit of another. Courts of equity have F always enforced claims by beneficiaries against trustees even though the former are, strictly speaking, strangers to the original agreement between the settlor and the trustee. See: *Takako Sakao (f) v Ng Pek Yuen (f) & Anor* [2009] 6 MLJ 751, para [29].

G

[30] Statutes may also operate as exceptions to the rule. The United Kingdom enacted the Contracts (Rights of Third Parties) Act 1999 to expressly allow third parties to enforce contractual claims.

H **[31]** A similar situation is true of contracts for motor insurance. Originally, a person named as a beneficiary in an insurance policy but not himself the policyholder, was not entitled to indemnity from the insurer due to lack of privity. See generally: *Vandepitte v Preferred Accident Insurance Corpn of New York* [1933] AC 70.

I

[32] The law in England was later amended to expressly confer named beneficiaries the right to claim indemnity from insurance companies even if they are not the policyholder. A similar provision is found in our road traffic legislation. See:

(a) s 36(4) of the Road Traffic Act 1930 (England);

(b) s 91(3) of the Road Transport Act 1987 (Malaysia); and

(c) *Tattersall v Drysdale* [1935] 2 KB 174 at pp 180–181.

[33] How does the doctrine of privity factor into 'mortgagee clauses'? To answer that question, one should appreciate what such a clause is. Our analysis indicates that there are a variety of ways in which a creditor may protect his interest in a property charged in his name. We refer to the article by Harry Cooper on *The Effect of the Standard Mortgage Clause in Insurance Policies* (1936) Vol 12(1) article 5, at pp 51–52. There are typically four ways in which a creditor might protect the said interest:

Four methods of securing protection have been commonly used:

1. *A policy between the insurer and the mortgagee as insured*. It is generally recognized by the courts that both the mortgagee and the mortgagor have an insurable interest in the mortgaged property since 'a person has an insurable interest in property when he sustains such relations with respect to it that he has a reasonable expectation, resting on a basis of legal right, of benefit to be derived from its continued existence, or of loss or liability from its destruction'. Although this method affords full protection to the mortgagee, it is seldom used because of the disadvantage to the mortgagee of paying the premiums, and the disadvantage to the insurer in the difficulty of supervising the risk, and because of the possibility of fraudulent collusion between the mortgagor and mortgagee.

2. *An assignment of the policy to the mortgagee by the insured mortgagor*. By this method the protection of the mortgagee is entirely dependent upon the conduct of the mortgagor, for when an assignment is made without an actual transfer of the subject of the insurance, the validity of the policy depends upon the acts or neglect of the mortgagor. In other words, the mortgagee stands in the position of his mortgagor with respect to the insurance contract.

3. *A 'loss-payable clause' in the policy*. Under this plan the policy contains an endorsement as follows: 'Loss, if any, payable to — mortgagee, as — interest may appear, subject nevertheless to all the conditions of this policy'. Under this clause the mortgagee is merely an appointee of the insured mortgagor, and is subject to all the defenses to which the insured would be subject. *Consequently this method has the same disadvantages with respect to the mortgagee as an assignment.*

4. *A 'Standard, or Union, Mortgage Clause' in the policy. This is now the most commonly used and the best method of protecting the interest of a mortgagee in insured property. The New York Standard Mortgage Clause is the leading form of the clause* and is as follows: 'Loss or damage, if any, under this policy, shall be payable to — as — mortgagee (or trustee) as interest may appear, and this insurance, as to the interest of the mortgagee (or trustee) only therein, shall not be invalidated by any act or neglect of the mortgagor or

owner of the within described property, nor by any foreclosure or other proceedings or notice of sale relating to the property, nor by any change in the title or ownership of the property, nor by the occupation of the premises for purposes more hazardous than are permitted by this policy; Provided, that in case the mortgagor or owner shall neglect to pay any premium due under this policy, the mortgagee (or trustee) shall on demand pay the same. 'Provided also, that the mortgagee (or trustee) shall notify this company of any change of ownership or occupancy or increase of hazard which shall come to the knowledge of said mortgagee (or trustee) and, unless permitted by this policy, it shall be noted thereon and the mortgagee (or trustee) shall, on demand, pay the premium for such increased hazard for the term of the use thereof; otherwise this policy shall be null and void. This company reserves the right to cancel this policy at any time as provided by its terms, but in such case this policy shall continue in force for the benefit only of the mortgagee (or trustee) for ten days after notice to the mortgagee (or trustee) of such cancellation, and shall then cease, and this company shall have the right, on like notice, to cancel this agreement. Whenever this company shall pay the mortgagee (or trustee) any sum for loss or damage under this policy and shall claim that, as to the mortgagor or owner, no liability therefor existed, this company shall, to the extent of such payment, be thereupon legally subrogated to all the rights of the party to whom such payment shall be made, under all securities held as collateral to the mortgage debt or may, at its option, pay to the mortgagee (or trustee) the whole principal due or to grow due on the mortgage with interest, and shall thereupon receive a full assignment and transfer of the mortgage and of all such other securities; but no subrogation shall impair the right of the mortgagee (or trustee) to recover the full amount of — claim. (Emphasis added.)

The impugned mortgagee clause

[34] The mortgagee clause which is at issue in the present case reads as follows:

C006(A) Mortgagee (Chargee) Clause 1

Loss, if any, payable to (as per Schedule) as Mortgagee (Chargee) as interest may appear in this Insurance, as to the interest of the Mortgagee (Chargee) only therein, shall not be invalidated by any or neglect of the Mortgagor (Chargor) or the Owner of within described property nor any foreclosure or other proceedings or notice of sale relating to the property or by the occupation of the premises for purposes more hazardous than are permitted by this Policy, or the non-occupation thereof, or by any other risk of increase taking place in the property insured hereunder. Provided that in the case the Mortgagor (Chargor) or Owner shall neglect to pay any premium due under this Policy the Mortgagee (Chargee) shall on demand pay the same. Provided also that the Mortgagee (Chargee) shall notify the Company of any non-occupancy or any change of ownership or occupancy or increase of hazard which shall come to the knowledge of the said Mortgagee (Chargee) and unless permitted by this Policy it shall be noted thereon and the Mortgagee (Chargee) shall

on demand pay the premium for such increased hazard for the term thereof otherwise this Policy shall be null and void.

And it is further agreed that whenever the Company shall pay the said Mortgagee (Chargee) any sum in respect of loss or damage under this Policy and shall claim that as to the Mortgagor (Chargor) or Owner no liability thereof existed, the Company shall become legally subrogated to all the rights of the Mortgagee (Chargee) to the extent of such payment but not so as to impair the right of the said Mortgagee (Chargee) to recover the full amount of any claim it may have on such Mortgagor (Chargor) or Owner or any other party or parties insured hereunder or from any securities or funds available. (Emphasis added.)

[35] At first blush, reading only the first paragraph of the mortgagee clause, it appears to constitute a 'loss payable' clause. As pointed out by Harry Cooper, a 'loss payable' clause is no different from an assignment. In explaining 'loss payable' clauses, the court below and the first and second respondents here rely on the following extract from Malcolm Clarke in *The Law of Insurance Contracts* (2nd Ed) which reads as follows (at para 5-1A):

> Some policies direct that the insurance money shall be paid to a named third party, such as a creditor of the insured. Such a clause, known as a loss payable clause, gives no rights to the loss payee *unless it also constitutes or evidences an assignment of the insured's rights under the policy or evidences an assignment of the insured's rights under the policy* or evidences the fact that the designated person is an original assured'. A simple form of the loss payee clause, however, is not as an assignment of the policy proceeds. Such a clause purports to benefit a third party, the loss payee, and is subject to the rule of privity against enforcement by the third party, and subject to the exceptions to or evasions of that rule in the law of insurance discussed the pages that follow. *Moreover, the loss payee can be in no better position that the insured through whom he is, if at all, entitled to the insurance money*. (Emphasis added.)

[36] In this regard, we find, with respect, the Court of Appeal failed to read the mortgagee clause in its entirety. The second paragraph which is emphasised in para 24 above appears to have escaped the Court of Appeal's scrutiny. Reading the clause as a whole, it is in our view, that word for word, it is a standard New York mortgage clause (also known simply as a 'standard mortgagee clause'). It is not merely a 'loss payable' clause.

[37] We have, by reproducing the article by Harry Cooper, highlighted the stark difference between the two concepts. But we think for clarity, it would be pertinent to explore in greater detail the mechanism of mortgagee clauses.

[38] One of the earliest cases on the subject is the decision of the New York Court of Appeals in *Hastings v Westchester Fire Ins Co* (1878) NY LEXIS 591; (1878) 73 NY 141. The facts were these. The relevant insurance policy contained a mortgagee clause effectively stipulating that should the insured,

whether prior or subsequent to the issue of the policy enter into some other policy, his insurance coverage thereunder would be reduced. The mortgagee clause was preceded by the following words (very much like the one in the present case): *'this insurance, as to the interest of the mortgagee only, shall not be invalidated by any act or neglect of the mortgagor or owner of the property insured'*. (Emphasis added.)

[39] The insured subsequently took out another insurance policy. The question was whether the mortgagee (like the mortgagor) would suffer reduced coverage as a result of the insured (mortgagors) conduct. The New York Court of Appeals held that it was not reduced because the mortgagee clause constituted a separate and independent contract.

[40] The bulk of the issues raised and answered in the aforesaid case, to our mind, answer those raised in the present appeal.

[41] We consider first, the judgment of Rapallo J, who in concurrence with the majority held as follows:

> I think the intent of the clause was to make the policy operate as an insurance of the mortgagors and the mortgagees separately, *and to give the mortgagees the same benefit as if they had taken out a separate policy, free from the conditions imposed upon the owners, making the mortgagees responsible only for their own acts. It established a privity between the company and the mortgagees*, and provided that, notwithstanding that the insurance might be invalidated as to the mortgagors, it should, nevertheless, protect the mortgagees; *and, as a consideration for this undertaking, it was stipulated that, in case the company should be called upon to pay the mortgagees, under circumstances which discharged it from liability to the mortgagors, it should be indemnified by subrogation, or an assignment of the mortgage and all securities held by the mortgagees for the mortgage debt*. This provision, in case the policy were invalidated as to the mortgagors, made it, in substance, an insurance solely of the interest of the mortgagees, by direct contract with them, unaffected by any questions which might exist between the company and the mortgagors. The same consequences would follow, pro tanto, from a partial, as from an entire invalidation, or a reduction of the policy as to the mortgagors. (Emphasis added.)

[42] With Rapallo J's judgment as the backdrop, we now turn to consider the views of Miller J who wrote for the majority. The learned judge began his judgment by noting that at the forefront, the court must give effect to the intention of the parties to the insurance contract. By including the mortgagee clause, the insurers clearly manifested an intention to protect the mortgagee. Miller J held as follows:

> A contract of insurance stands upon precisely the same basis as any other agreement and, in accordance with a general rule, must be interpreted according to its purport in connection with the facts and circumstances which attend its execution. *The*

main object should be to carry out and to give effect to the intention of the parties ... A

At the time when the contract, expressed in the entry upon the policy of insurance, and in the stipulation to which we have referred, was made, *it appears to have been quite obvious that the design of the parties was to secure to the plaintiffs the amount named in the policy of insurance in case of loss by fire, and that the defendant should pay the whole amount of any loss, with the right of subrogation, in the place of the plaintiffs, in case of the happening of the contingency stated therein.* (Emphasis added.) B

[43] He then went to consider the privity argument which is in effect the same as the argument before. The learned judge rejected such a claim on the grounds that the mortgagee clause effectively created a separate and independent contract between the insurers and the mortgagee. He held: C

It is claimed, however, by the appellant's counsel, that the policy was an insurance of the interest of the owner of the property solely; that such owner was the assured, and the defendant only agreed to make good the loss of such owner; and inasmuch as another policy existed at the time, in favor of such owner, although entirely unknown to both the plaintiffs and the defendant, the latter was entitled to the benefit of the condition contained in its policy, which declares that in case of any other insurance, whether prior or subsequent to the date of the policy, the assured was entitled to recover no greater proportion of the loss sustained than the sum insured bears to the whole amount insured thereon. *This position cannot, I think, be maintained.* Prior to the time when the mortgage clause was entered upon the policy, the word 'assured' referred to the owner, and it is hardly to be assumed that the mortgagees would have accepted such a provision if there was any reason to suppose that they would be affected by any prior insurance. *They would, no doubt, have demanded a separate policy as mortgagees, instead of trusting to the hazard and uncertainty of pursuing a remedy upon a policy of which they had no knowledge, and against a company to which they were strangers, and in regard to whose responsibility they had no information whatever.* (Emphasis added.) D E F

G

[44] The gist of what Miller J held was this. The mortgagee clause manifested a separate and independent contract between the insurer and the mortgagee. The consideration for the contract was the right of subrogation. With this right, the insurer was required to reimburse the mortgagee the money owed, but by doing so, acquired the right to take the place of the mortgagee to sue the party at fault for the recovery of the sum paid by the insurer to the mortgagee. H

[45] Miller J in the following words does not expressly describe the subrogation as being consideration but reading the following words with the concurring judgment of Rapallo J, it can be inferred that, that was what Miller J meant. We reproduce below Miller J's views which we consider to be self-explanatory: I

A The legal effect of the mortgage clause was, that the defendant agreed that in case of loss it would pay the money directly to the mortgagees; and they were thus recognized as a distinct party in interest. *It created a new contract from that time with the mortgagees, the terms of which most clearly indicate that it had no relation to the application of the condition referred to.* The insurance had been to the owner, and the B additional provisions, *which were incorporated in the policy by the mortgage clause, created a distinct contract with the mortgagees. It was an independent agreement partaking in no sense of the character of an assignment of a policy of insurance, but one in which the mortgagees were recognized as a separate party, having distinct rights, and entitled to receive the full amount of insurance money, without any regard whatever to* C *the owner of the property* ...

The interest of the latter was distinct and separate when this change in the policy was made, and the intention of the parties was, beyond question, to insure the plaintiffs under a new contract. *Any different interpretation would lead to great injustice, and place the mortgagees under the control and at the mercy of the owner, by* D *changing the character of the defendant's liability, which might operate to prevent the indemnity which the defendant intended to provide*. If the condition referred to was in force either before or after the arrangement, the owner might effect other insurance, and thus jeopard the rights, if not entirely control the security, of the plaintiffs. (Emphasis added.)

E

[46] The position is the same in Canada. Two points are relevant here. Firstly, that the Canadian courts have strongly rejected the privity point by upholding mortgagee clauses as having created a separate and independent contract between the insurer and the mortgagee. In *Trans Canada Credit* F *Corporation v Royal Insurance Company of Canada* [1983] NSJ No 440; 149 DLR (3d) 280, the trial judge made the following observations with which on appeal, Jones JA of the Nova Scotia Supreme Court seemed to be in agreement with (at para 5):

G *It has been the acknowledged commercial practice for over 100 years in both Canada and the United States to recognize and to give legal effect to loss-payee clauses in policies of insurance of various kinds. It would be disruptive of those commercial practices as they exist today if, suddenly, the validity of policies of insurance containing mortgage clauses or loss-payee clauses was called into question.* It would be better if the Legislature of the H Province of Nova Scotia saw fit to amend the existing Insurance Act or to enact other Legislation in order to effect a statutory solution of this long-standing problem *but, in the absence of such legislation, the courts have a duty to ensure that all parties to substantial obligations live up to the covenants which they have made and which they know or should know will be relied upon by others.* (Emphasis added.)

I

[47] The above passage suggests that this 'separate and independent contract' has been the preferred approach for a considerable length of time. Further, it developed and gained traction through judicial decisions. It was not an approach imposed by statute. We will come back to this point shortly.

[48] We refer to the decision of the Supreme Court of Canada in *Caisse Populaire des deux Rives v Société Mutuelle d'Assurance Contre l'Incendie de la Vallée du Richelieu*, the facts of which are directly relevant to those in the present appeal.

[49] A farmer had obtained security for a loan over certain immovable property. One of the conditions of the loan was that the farmer had to undertake to insure this property. In accordance with that clause the farmer purchased an insurance contract with the insurers. It was later found that the farmer intentionally burned down the property. The insurance contract provided that in the event of loss the indemnity was payable to the respondent, under the mortgagee clause (which the judgment styled as 'the hypothecary clause').

[50] The mortgagee brought an action against the appellant, claiming $112,359.50 as the loss suffered on the date of the fire. The lower court ordered the appellant to pay the respondent $62,726.50 with interest and costs premised on the value of the insured property and the limit of the insurance contract. This was affirmed on appeal. The matter was then taken up to the Supreme Court of Canada. The question there was whether the insurer was liable to pay the mortgagee under the mortgagee clause even though the mortgagor farmer was essentially guilty of fraud.

[51] The Supreme Court upheld the lower courts' decisions. It noted the four requisites to the formation of contracts, namely:

(a) parties legally capable of contracting;

(b) their consent legally given;

(c) something which forms the object of the contract; and

(d) a lawful cause or consideration.

[52] We pause to note that all of the above requirements are in conformity with our Contracts Act 1950 and our general body of case law. After examining all four requirements above, the Canadian Supreme Court noted that all the above features were present in the mortgagee clause.

[53] Perhaps the most controversial of the four elements is the consideration requirement. On that point, the court opined as follows:

> In a recently published article (Simard, 'La faute intentionnelle de l'assuré et la clause de garantie hypothécaire' (1987), 21 RJT 335), counsel for the appellant rejected the interpretation that treats the policy as two contracts on the ground that there was no consideration given by the hypothecary creditor in return for the entitlement to the indemnity given by the insurer ...

> *In my view, this argument does not seem well founded, since there is indeed a pecuniary consideration in the second insurance contract between the hypothecary creditor and the insurer. The consideration given to the insurer for the increased risk is included in the premium as determined by the policy and paid by the hypothecary debtor*. The latter pays not only the premium for his insurance contract but also that payable under the hypothecary creditor's insurance contract, by an imperfect delegation of payment ...
>
> The hypothecary debtor thus pays all the premiums, covering both that applicable to his insurance interest, covered by his insurance contract, and that applicable to the hypothecary creditor's insurance interest, covered by the second insurance contract. The respective insurance interests of the hypothecary creditor and the hypothecary debtor, the sum of which is always equal to the total value of the insurance policy, vary in a manner inversely proportional to the rate of repayment by the hypothecary debtor of the capital loaned, and are finally entirely absorbed by that of the hypothecary debtor when the hypothecary loan is repaid in full. *Consideration thus exists for the separate insurance contract evidenced by the hypothecary clause.* (Emphasis added.)

[54] See also the judgment of the Ontario Court of Appeal in: *Pinder v Farmers' Mutual Insurance Co (Lindsay)* [2009] OJ No 4964; 313 DLR (4th) 482.

[55] The American and Canadian courts recognise that mortgagee clauses (like the one in our case) create a separate and independent contract between the insurer and the mortgagee. The mortgagee might be tasked to pay the premiums when demanded, and the rights of the mortgagee to sue the party at fault may be subrogated to the insurer. To put it in simple terms, the mortgagee clause in this case created the privity between the appellant on the one hand and the first and second respondents on the other hand. The Court of Appeal in our view erred in law by holding that the appellant lacked locus standi.

Foreign judgments

[56] The court below opined, and it was also argued before us that we ought not to adopt the Canadian and American positions as they are specific to these jurisdictions. Our analysis of those judgments does not lead us to that conclusion. Referring mainly to the decisions in New York Court of Appeal in *Hastings*, and the Canadian Supreme Court in *Caisse*, the said decisions were not grounded on any statutes unique to those jurisdictions. The developments were made judicially.

[57] In any event, even if we were to turn to the English common law, we find that the legal position in most cases is the same as that found in the American and Canadian cases. The way the English courts have approached it is by drawing a distinction between composite and joint policies.

[58] Rix J in *Arab Bank plc v Zurich Insurance Co Banque Bruxelles Lambert SA v Zurich Insurance Co and another* [1998] All ER (D) 273 explained the difference between the two as follows:

> Normally, a policy does not deal specifically with the dishonesty of an assured, save possibly to include an express term, which would otherwise be implied, to say that fraud in the making of a claim would render the policy forfeit ... It is likewise implicit in the nature of insurance that a loss caused by the deliberate dishonesty of an assured is not covered: this is reflected in section 55(2)(a) of the Marine Insurance Act 1906 which provides that the insurer is not liable for any loss attributable to the wilful misconduct of the assured. *Even so, it is implicit in the nature of a composite policy that one assured is not prejudiced by the dishonesty of another, provided that the other is not a joint assured*: ...

[59] The distinction between joint and composite policies was lucidly explained by our Federal Court in *Standard Chartered Bank v KTS Sdn Bhd* [2006] 4 MLJ 617; [2006] 4 CLJ 79. At para 36 of the judgment Siti Norma Yaakob FCJ described composite policies as follows:

> There are some essential legal differences between a composite and a joint policy. *A composite policy consists of a number of contracts in a single document, a breach of duty or misrepresentation of which does not affect the rights of an innocent composite assured. Therefore a false statement by a mortgagor will not affect the rights of the mortgagee.* (See *Woolcott v Sun Alliance* [1978] 1 Lloyd's Rep 629). A misconduct by one of the parties to a composite policy will not defeat the rights of the other party. (See *Lombard v MRMA Insurance* [1969] 1 Lloyd's Rep 575). *Again under a composite policy each party has a separate contract with the insurer and has to be paid individually.* Further there is no joint risk; there is no joint interest; the measure of loss suffered by the two parties will be different, calling for a different measure of indemnity and there is no joint element on the property insured. In *General Accident v Midland Bank* [1940] 2 KB 388 where an insurer, having made payment to three co-assureds under a composite policy, sought to recover its payment from two of them on the basis that the loss had been deliberately caused by arson. It was held that the insurer had to seek restitution from the party to whom it had made payment and could not recover the totality of its payments from any co-assured. (Emphasis added.)

[60] Her Ladyship then went on to define joint policies in the following manner (at para 37):

> On the contrary, in a joint policy if one assured has been guilty of misrepresentation or of some breach of duty, neither can recover. Secondly a deliberate destruction of the insured subject matter by a joint assured person will prevent any recovery under the policy. *Further the rights of the individual assureds under a composite policy are independent whereas in a joint policy the rights of the assureds are indivisible and will stand or fall together.* (Emphasis added.)

[61] In that case, the Federal Court declined to rule in the mortgagee's favour because the policy in question only indemnified banks recognised in the schedule attached to that policy. The bank in that case could not prove that it was so recognised. See: *Standard Charted*, at paras 42 and 43. In the present case however, it is undisputed that the appellant is a chargee recognised under the Schedule.

[62] This fact was also acknowledged by one of the adjusters, Mestari Adjusters Sdn Bhd in a letter dated 28 April 2009 which reads as follows:

> In view that RHBIBB'S [the Appellant's] interest as Chargee is noted in your above fire policies, we are extending a copy of this letter to the Bank to keep them informed to which we trust you have no objection.

[63] Juxtaposing the English position with the position in the United States and Canada, it would appear the courts there have a unified reasoning on mortgagee clauses. Whether one calls it a 'composite policy' or otherwise, it is manifestly clear that the intention behind the drafting of the mortgagee clause was to create a separate and independent contract with distinct terms and conditions between the appellant and the first and second respondents. In view of the unified approach taken by the courts in these countries we see no reason to arrive at a different conclusion especially as, as we have noted earlier, the mortagagee clause in our case is word for word almost identical with the standard New York mortagagee clauses.

Public policy

[64] On this issue, to recapitulate, the Court of Appeal found that allowing the appellant's claim would conflict with public policy. The first and second respondents canvassed the same point before us. With respect we are unable to agree with the Court of Appeal and the first and second respondents.

[65] Firstly, in this context, the Court of Appeal's view that an assignee cannot be in a better position than the assignor is, in our considered view, incorrect. Based on what we have elucidated above, standard New York mortgagee clauses do not amount to assignments. They are separate and independent contracts. Therefore, the question that the assignee cannot be in a better position than the assignor does not arise.

[66] Secondly, taking the above quoted words of Miller J in *Hastings*, the Court must give effect to the intention of the contracting parties. A plain reading of the mortgagee clause shows that the first and second respondents intended to indemnify the appellant notwithstanding any disentitlement of the third respondent to the same.

[67] On this point, also relevant is the observation of the Supreme Court of Canada in *Caisse*.

> In the second insurance contract contained in the policy, the hypothecary creditor and not the debtor is the insured. Accordingly, the hypothecary creditor is not benefiting from his intentional fault when he claims to be entitled to the insurance indemnity as a result of the fire caused by the intentional fault of his debtor. In such circumstances, the insured (the hypothecary creditor) has not committed any fault, intentional or otherwise. Neither does the hypothecary debtor benefit from his intentional fault, since the payment of the indemnity by the insurer does not result in his release, but simply a substitution of debtor (subclause (b) of the hypothecary clause). *Thus, moral considerations discussed above do not stand in the way of indemnifying the hypothecary creditor* ...
>
> *When dealing with a hypothecary clause evidencing a separate insurance contract with the insurer, as is the case here, fault by the hypothecary debtor must be treated as fault by a third party* ... since the creditor and not the debtor is the insured. Consequently, the clause stating that the hypothecary debtor's intentional fault cannot be set up against the hypothecary creditor in no way contravenes that provision. (Emphasis added.)

[68] In other words, because the contract of indemnity between the insurers and the mortgagee exists independently from the contract between the insurers and the insured, the finding of fraud (or any other vitiating factor) as between the insured and the insurer has no bearing to the claim of the mortgagee. The validity and entitlement of the mortgagee to the insurance proceeds must be assessed on the conduct of the mortgagee alone.

[69] We agree with the appellant that the principle that a man should not profit from his wrong has no obvious application to an innocent mortgagee. As submitted by learned counsel for the appellant the insured does not benefit from its own wrong doing as the insurer after having made payment to the mortgagee when there is no liability to pay the insured is entitled to sue and recover the amount paid under its subrogation right.

[70] That is the reason why the wording of the mortgagee clause is as such and that upon payment of the sum to the mortgagee, the insurer shall become legally subrogated to all the rights of the mortgagee to the extent of such payment and may thus have a right of recovery against the insured.

[71] One of the chief purposes of subrogation is to place the loss ultimately on the wrongdoer or tortfeasor who caused the loss in the first place. Courts have stressed that one goal of subrogation is to place the burden for a loss on the party ultimately liable or responsible for it and by whom it should have been discharged, and to provide relief entirely to the insurer who indemnified the loss and who in equity can recover such loss.

A **[72]** As there is a right of subrogation and the insurer has the absolute right to bring a suit against the insured to the extent of the monies paid to the mortgagee, the issue of public policy and the insured benefitting by reason of payment to the mortgagee does not apply at all.

B **[73]** The mortgagee clause clearly provided that when a mortgagee is paid where no liability existed then the insurer, the first and second respondents in this case are subrogated to all the rights of the mortgagee to the extent of such payment and will be entitled to recover this sum from the insured in default. In this regard we agree with the appellant that this important fact was not
C considered by the Court of Appeal.

[74] On this issue, the learned author Harry Cooper indicates that there is a policy reason to uphold mortgagee clauses. In the United States where such
D clauses were conceived, about 60 percent of property is mortgaged. This prompted the courts to extend the extent of coverage in favour of mortgagees.

[75] The appellant contended that the judgment of the Court of Appeal puts in jeopardy the interest and security of all the banks in Malaysia who are
E inevitably stated as mortgagees in millions of fire policies that currently exist and consequently it will appear that banks and the banking industry will have to continuously monitor whether the insured/borrower complies with the terms and conditions of the policy. In this sense, it appears the policy reason to uphold mortgagee clauses in other jurisdiction remains equally relevant in a
F Malaysian context.

[76] Both the mortgagee and the insurer in any given case bear a risk. Giving out a loan involves the risk of non-repayment. It is a risk of suretyship.
G Indemnity insurance however involves the purchase of risk of loss. So in fire insurance cases, the insurer enters into the insurance contract acknowledging full well the risk of having to compensate potential loss. It is for this reason, as gleaned from the learned author Harry Cooper's reasoning, that courts are moved to uphold standard mortgagee clauses in favour of mortgagees. After
H having manifested the intention to indemnify the appellant via the mortgagee clause, it cannot therefore be the case that the first and second respondents were entitled to evade such contractual responsibility.

I **[77]** For completeness, we quote the learned author from pp 51 and 62:

> By 1922, one authority states, 60 per cent of the realty in the United States was mortgaged. To secure this protection, there has been both a growth of insurance covering the mortgagee's interest, and an increase in the measure of protection afforded him ...

> However, the preponderance of interest would be determined by the circumstances of the case, that is, upon whom should fall the risk of the mortgagor's conduct at the inception of the mortgage clause. If the circumstances indicate this to be a risk of suretyship, the mortgagee should bear it, but if they indicate it to be a risk of insurance, the insurer should bear it.

[78] For the foregoing reasons, and bearing strictly in mind that we are dealing with a standard mortgagee clause as contained in the FMD Policy 005, we would answer leave question (i) in the affirmative and leave questions (ii) and (iii) in the negative.

The deed of assignment

[79] In light of what we have decided above, the mortgagee clause clothed the appellant with the necessary locus standi to sue the first and second respondents for the insurance proceeds. Thus, we think it necessary issues surrounding the deed of assignment have become academic. Therefore, we consider it unnecessary to answer leave questions (iv) and (v).

The final analysis

[80] There is a final point which we have to deal with. The first and second respondents brought to our attention that subrogation is impossible in this case as the appellant has obtained summary judgment against the third respondent for the same amount of the debt owing under the facilities. See generally: *RHB Islamic Bank Berhad v Veheng Global Trader Sdn Bhd & Ors* [2011] 1 LNS 684. We do not think this contention is sustainable on the facts and the law.

[81] We have closely scrutinised the language of the second paragraph of the mortgagee clause. For clarity, we think the crucial portion bears repetition. To better understand it we broke it down to its constituent parts:

> i. ... the Company shall become legally subrogated to all the rights of the Mortgagee (Chargee) to the extent of such payment but
>
> ii. *not so as to impair the right* of the said Mortgagee (Chargee) to:
>
> (a) recover *the full amount of any claim it may have on such Mortgagor (Chargor)* or
>
> (b) (b) Owner or any other party or parties insured hereunder or from any securities or funds available. (Emphasis added.)

[82] A literal reading of the above indicates that the right of the insurers is without prejudice to the right of the mortgagee to claim the full amount of the outstanding debt. It stands to reason that the intention of the parties was that should the mortgagor or any other third party occasion loss, it would be open

to the mortgagee to claim indemnity from the insurers *and* at the same time, claim the full amount from the mortgagor. For the reasons mentioned earlier, courts are duty bound to give effect and carry out the intention of the parties to the contract.

[83] We have scoured the law reports for authorities to determine whether our view is fortified in law. We have found one case directly on point. It is the judgment of the District Court of Georgia in *Corbin v Aetna Life & Casualty Co* (1978) US Dist LEXIS 19436; (1978) 447 F Supp 646.

[84] The facts have already been summarised and we reproduce them as follows. A homeowner's property was damaged by fire, and the insurers refused to pay his claims under two separate homeowner's insurance policies. The homeowner defaulted on his mortgage, which prompted the first mortgagee to foreclose on the property.

[85] The insurers argued that by foreclosing on the property subsequent to a loss, the first mortgagee extinguished its rights to insurance proceeds as the loss payee on the policy in the amount of the foreclosure. The question before the court was whether the mortgagee was entitled to the indemnity notwithstanding that it had satisfied its debt via the forfeiture.

[86] The court rejected the insurer's argument as otherwise, it would have amounted to a windfall for the insurers were they allowed refusal to pay under the policy. The court was of the view that the insured should not be required to preserve its contractual rights by initiating lengthy, expensive litigation prior to foreclosure. Such wasteful litigation could be avoided, at least in part, by establishing as a rule of law the date of the loss as the date when adverse rights were to be determined. The court granted the first mortgagee's motion for partial summary judgment as to liability and denied the insurers' motions to dismiss the action.

[87] In our view, the court in that case made two pertinent observations. The first was in relation to the injustice occasioned by the insurer's refusal to pay. Freeman J held:

> *The defendants' argument that the insured could have preserved its rights by filing suit prior to foreclosure, is not well-taken*. This court will not reward unreasonable delay by insurers, neither will we, as a general rule, condition an insured's recovery on the filing of a lawsuit. Resort to the courts should be the exception and not the rule of contract performance. *Standard Federal [the mortgagee] appeared eminently reasonable in seeking settlement and in foreclosing when it did.*
>
> Insureds should not be required to preserve their contractual rights by initiating lengthy, expensive litigation prior to foreclosure. Such wasteful litigation can be obviated, in part, by establishing as a rule of law the date of the loss as the date when

adverse rights are to be determined. The extent of the mortgagee's interest at the time of the loss sets the bounds of its possible recovery with an allowance for damages caused by delay or any bad faith which can be demonstrated. *Neither later extinguishment nor augmentation of the debt should alter an insurer's liability and thus the state deficiency judgment procedures* ... (Emphasis added.)

[88] The District Court of Georgia had also occasion to consider the relevant portion of the mortgagee clause which is, for all intents and purposes, in pari materia with the one in the present case. On this point, the court held:

Defendants' [the insurers'] subrogation rights in an action against the mortgagor or some other third party were not impaired upon the mortgagee's foreclosure. *The terms of the standard clause deny such a result*:

> Whenever [the insurer] shall pay the mortgagee ... any sum for loss under this policy ... this 'insurer' shall, to the extent of such payment, be thereupon legally subrogated to all the rights of the party in whom such payment shall be made, under all securities held as collateral to the mortgage debt, or may, at its option, pay to the mortgagee ... the whole principal due or to grow due on the mortgage with interest and shall thereupon and of all such other securities; but no subrogation shall impair the right of the mortgagee ... to recover the full amount of said mortgagee's ... claim.

Subrogation rights vest only upon payment of the claim to the insured. The amount of settlement with the mortgagee would have determined the extent of loss to be pursued against a wrongdoer who may have ultimately caused the loss. *If defendants had been concerned about their subrogation rights, they should not have been loath to compensate the insured upon its rightful claim*. By the terms of the contracts, Standard Federal did not impair the insurers' subrogation rights when it foreclosed on the Corbin property after a seven-month default. (Emphasis added.)

[89] We think the above case also puts into perspective our point on the distinction between the risks of suretyship and insurance. Taking the above case analogously, and applying them into the context of this case, the mortgagee clause effectively allows the mortgagee to enforce his contractual rights against the mortgagor for any outstanding sum of the loan. At the same time, the mortgagee may also enforce his contractual right of indemnity against the insurers. The former is the mortgagee's enforcement of suretyship. The latter is the mortgagee's right to claim indemnity upon the materialisation of the risk.

[90] In plain language, the terms of the mortgagee clause herein expressly enabled the appellant to seek out full settlement of its outstanding debt. Doing so was not inconsistent with its right to claim indemnity from the first and second respondents.

[91] Further, on the evidence, the said respondents repudiated liability to the appellant vide a letter dated 16 July 2009. The summary judgment in favour of

A the appellant against the third respondent was granted on 3 June 2011 which was a period of almost two years from the first and second respondents' repudiation. Taking heed from the rationale of the above-cited judgment of the District Court of Georgia, the appellant was within its rights to pursue the summary judgment without prejudicing its claim.

B

[92] At the outset of this judgment we stated that the central issue in this judgment is whether the appellant is entitled to the insurance proceeds from the first and second respondents. In our view the High Court judge was correct in his interpretation of the mortgagee clause. It therefore follows that the C appellant is entitled to be paid the proceeds of the insurance by the first and second respondents. As to how much the appellant is entitled to be paid, we observe that the Court of Appeal disagreed with the High Court's findings on quantum. To recapitulate, the High Court awarded the sum of RM38,799,784 to the third respondent and the appellant. The Court of Appeal however D expressed the view that based on the first and second respondents' own adjuster's report, at the most the value of the loss is RM23.36m. We therefore consider that RM23.36m is the appropriate sum that the appellant is entitled to.

E CONCLUSION

[93] For the reasons stated above, we would allow the appeal with costs and set aside the order of the Court of Appeal. We restore the order of the High Court but vary the amount awarded from RM38,799,784 to RM23.36m for F the reasons indicated earlier.

Appeal allowed unanimously, COA's decision set aside, order of the High Court restoring but varying the amount awarded to RM23.36m.

G Reported by Ashok Kumar

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